

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF AUXIER WATER)
COMPANY, INC., FOR AN ADJUSTMENT)
OF RATES PURSUANT TO THE) CASE NO. 9015
ALTERNATIVE PROCEDURE FOR)
SMALL UTILITIES)

O R D E R

On March 13, 1984, the Auxier Water Company, Inc., ("Auxier Water") filed an application with the Commission to increase its water rates pursuant to 807 KAR 5:076. This regulation allows utilities with 400 or fewer customers or \$200,000 or less gross annual revenues to use the alternative rate filing method in order to minimize the necessity for formal hearings, to reduce filing requirements and to shorten the time between the application and the Commission's final Order. This procedure should minimize rate case expenses to the utility and, therefore, should result in lower rates to the ratepayers.

The Auxier Community Development Club and the Attorney General's Division of Consumer Protection ("AG") intervened in this matter.

On June 4, 1984, Auxier Water filed additional information seeking to amend its original filing. Both intervenors filed motions requesting that the Commission dismiss the proposed amendment, stating that the amendment constituted a new rate

filing and that no notice of proposed rate changes was provided to customers of Auxier Water. The Commission agrees with the intervenors that it would be inappropriate to consider such an amendment and, therefore, has not considered the additional information in determining fair, just and reasonable rates to Auxier Water.

Auxier Water requested rates which would produce an annual increase of \$47,761 from its 517 customers. In this Order, the Commission has allowed rates to produce an increase of \$14,218.

TEST PERIOD

For the purpose of determining the reasonableness of the proposed rates, the 12-month period ending December 31, 1983, has been accepted as the test period.

REVENUES AND EXPENSES

Auxier Water incurred a net loss for the test period of \$3,790. Auxier Water proposed several pro forma adjustments to its test period operating revenues and expenses to more accurately reflect current operating conditions. The Commission finds these adjustments reasonable and has accepted them for rate-making purposes with the following exceptions:

Transmission and Distribution Expense-Operation Supervision

During the test period Auxier Water's general manager received \$18,000 for services rendered. Auxier Water proposed an upward adjustment of \$6,000 which would give the general manager an adjusted salary for the test period of \$24,000. In its Order in Auxier Water's last rate case, Case No. 7869, dated October 31, 1980, Application of Auxier Water Company, Inc., for an Adjustment

of Rates, Auxier Water proposed and the Commission accepted the fiscal year ending April 30, 1980, as the test period. The salary found reasonable for rate-making purposes in that case for the general manager was \$12,000. Auxier Water did not present sufficient documentation or proof to justify that the responsibilities and duties of the general manager varied significantly from those performed during the test period in the last case.

The Commission finds it unreasonable for Auxier Water to expect its customers to bear such a large salary increase. The Consumer Price Index ("CPI") is a primary measure of inflation and since the date of the last Order, the fiscal year ending October 31, 1980, the change in the CPI through March, 1984, was 19.36 percent.¹ The CPI is frequently used by industry in setting wage increases and the Commission finds it to be useful in analyzing the salary adjustment in this instance. After giving due consideration to all factors involved in arriving at an equitable salary for the general manager, the Commission is of the opinion that the maximum increase for rate-making purposes that should be passed on to Auxier Water's customers is an increase equal to the change in the CPI since Auxier Water's last rate case. Therefore, the Commission has allowed an increase of \$2,323 to the \$12,000

¹ CPI=W Index:

$$\frac{\text{Fiscal Year March 1984}}{\text{Fiscal Year October 1980}} = \frac{303.3}{254.1} = 19.36\%$$

approved in the previous rate case which will have the effect of reducing Auxier Water's pro forma salary of \$24,000 by \$9,677.²

Administrative Salaries

Auxier Water proposed a pro forma salary for the office manager of \$9,600 per year. The Commission has compared the existing salary of the office manager of \$7,710 to those of other utilities of similar size and operating characteristics under the jurisdiction of the Commission and finds that \$7,710 per year is a reasonable salary for the utility to pay for this service and is, therefore, reasonable for rate-making purposes. Moreover, Auxier Water provided information in its response to the Commission's request for information received April 13, 1984, which stated that starting June 1, 1984, the office manager shall receive additional fringe benefits above the stated salary in the form of company sponsored Blue Cross-Blue Shield medical insurance premiums totaling \$1,606 per year. Therefore, the Commission is of the opinion that the office manager's actual annual compensation, including the new medical benefits, is fair and reasonable and thus no salary increase is warranted. The amount of compensation for the office manager allowed for rate-making purposes is, therefore, \$9,316.

² $\$12,000 \times 19.36\% = \$2,323 + \$12,000 - \$24,000 = \$(9,677)$

Payroll Taxes

Auxier Water projected pro forma payroll taxes for the test period of \$3,917. Based on the Commission's adjusted salary expense of \$31,633, payroll taxes have been reduced by \$968.³

Outside Services Employed - Legal

Auxier Water had recorded legal expense for the test period of \$140, and is requesting an adjustment to its test period expense to employ Burchett and Barber, Attorneys at Law, on a retainer fee basis of \$200 per month. The Commission has reviewed the outside accounting and legal costs of Auxier Water for a 3-year period and finds that the greater part of funds expended has been in the area of accounting services with virtually no legal services recorded or apparently required. Thus, based on the past legal service needs of Auxier Water, the Commission is of the opinion that it should prudently seek legal services as needed on an hourly basis rather than by retainer and has, therefore, disallowed the adjustment to the test period cost of \$2,260 for rate-making cost.

Employee Pensions and Benefits

During the test period, Auxier Water provided Blue Cross-Blue Shield medical insurance coverage for two of its employees,

³ Reduction in payroll tax expense:

Social Security Taxes - \$31,633 X 7% (1984 rate)	= \$2,214
Unemployment Taxes - \$21,000 X 3.5% (1984 rate)	= 735
Sub-total	<u>\$2,949</u>
Auxier Water's Pro Forma Payroll Taxes	<u>3,917</u>
Reduction in Payroll Tax	<u>\$ 968</u>

paying annual premiums of \$3,212. Blue Cross-Blue Shield notified Auxier Water that the premium would be increased from \$267.70 per month to \$326.10 per month effective February 1, 1984. The Commission is of the opinion that the annual increase in premium cost of \$701⁴ is allowable for rate-making purposes.

Office Equipment Rental

Auxier Water made a pro forma adjustment to test year expenses of \$1,200 for the purpose of renting a Pitney-Bowes postage machine at \$15 per month and an IBM copier at \$85 per month. The Commission is of the opinion that monthly rental charge for the postage machine of \$15 is allowable as it is essential to the customer billing function. However, Auxier Water has not demonstrated proof that there would be a sufficient need for copies of documents to justify the annual copier rental charge of \$1,020. Therefore, the Commission has reduced office equipment rental charges by \$1,020 for rate-making purposes.

Depreciation Expense

Auxier Water projected pro forma depreciation expense for the test period of \$20,973. The depreciation schedule for the year ended December 31, 1983, filed with Auxier Water's application, listed the following capital items and the corresponding period of depreciation as follows:

⁴ Computation of increase in insurance premium expense:

$$\$326.10 \times 12 - \$267.70 \times 12 = \$701.$$

Meters	5 years
Transportation Equipment	3 years
Hydrants	10 years

The Commission has reviewed the estimated average lives of these assets and finds the following periods of depreciation to be reasonable:

Meters	5 years
Transportation Equipment	5 years
Hydrants	40 years

Thus, the Commission has reduced depreciation expense by \$5,759 to reflect the depreciation periods set out above.

A further study of the depreciation schedule shows that Auxier Water has included pro forma depreciation expense of \$2,450 for a microcomputer system, a typewriter and office furniture which have neither been purchased nor contracted for to date. The Commission allows only known and measurable adjustments to test period expenses and has, therefore, denied this pro forma depreciation expense of \$2,450.

Finally, the Commission has further reduced depreciation expense by \$1,815 in accordance with its policy that depreciation should be computed on the basis of original cost of the plant in service less contributions in aid of construction. The Commission is of the opinion that it is unfair to require ratepayers to provide recovery on that portion of the plant provided free of cost.

Therefore, the Commission finds that the appropriate adjusted test period depreciation expense is \$10,949.⁵

Auxier Water's adjusted operations at the end of the test period are, therefore, as follows:

	<u>Auxier Water Adjusted</u>	<u>Commission Adjustments</u>	<u>Commission Adjusted</u>
Operating Revenues	\$ 158,709	\$	\$ 158,709
Operating Expenses	179,591	(25,138)	154,453
Net Operating Income	<u>\$ (20,882)</u>	<u>25,138</u>	<u>4,256</u>
Interest Expense	<u>1,877</u>		<u>1,877</u>
Net Income	<u>\$ (22,759)</u>	<u>\$ 25,138</u>	<u>\$ 2,379</u>

REVENUE REQUIREMENTS

The Commission is of the opinion that Auxier Water's adjusted net income of \$2,379 is unfair, unjust and unreasonable. The Commission in determining revenue requirements has considered numerous alternatives including the rate of return, debt service coverage, and operating ratio methods. The Commission is of the opinion that the operating ratio method is the appropriate method of determining revenue requirements in this instance because it

⁵ Computation of adjusted depreciation expense:

Pro Forma depreciation expense, December 31, 1983	\$20,973
Deduct:	
Adjustment based on extending period of depreciation on capital items	(5,759)
Disallowance of pro forma depreciation expense of 3 capital items	(2,450)
Sub-total	<u>\$12,764</u>
Disallowance of depreciation expense on contributed property: $\$35,790 \times 5.07\%$ (Composite rate - $\$12,764 \div \$251,740$ Plant in Service)	<u>(1,815)</u>
Adjusted test year depreciation expense	<u>\$10,949</u>

will most adequately permit Auxier Water to pay its operating expenses, service its debt, and provide a reasonable return to its owners. The Commission is further of the opinion that a fair, just and reasonable operating ratio is 92 percent in this instance in that the revenue produced should provide sufficient cash flow for Auxier Water to meet reasonable expenditures which it may incur in the next operating cycle. Therefore, the Commission is of the opinion that Auxier Water is entitled to increase its rates to produce an increase in annual revenue of \$14,218,⁶ which produces net income of \$13,684, including a provision for federal and state income tax expense of \$2,913.⁷ The Commission will continue to monitor the financial results of Auxier Water to determine whether the rates found reasonable herein require modification.

SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rates proposed by Auxier Water would produce revenues in excess of the revenues found reasonable herein and should be denied upon application of KRS 278.030.

2. The rates in Appendix A are the fair, just and reasonable rates to charge for water service rendered to Auxier

⁶ $\$157,366 \div .92 = \$171,050 + \$1,877 - \$158,709 = \$14,218.$

⁷ Taxable income X composite state and federal tax rate:
 $\$16,597 \times 17.55 \text{ percent} = \$2,913.$


Water's customers and should produce annual revenues from water sales of approximately \$167,293.


IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved as the fair, just and reasonable rates to be charged by Auxier Water for water service rendered on and after the date of this Order.

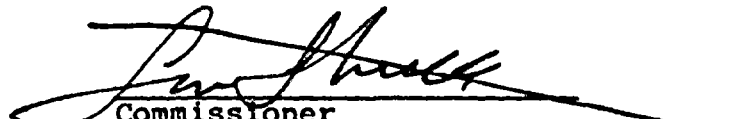
IT IS FURTHER ORDERED that, within 30 days of the date of this Order, Auxier Water shall file with this Commission its tariff sheets setting forth the rates approved herein and a copy of its rules and regulations for providing water service.

Done at Frankfort, Kentucky, this 13th day of July, 1984.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Acting Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 9015 DATED 7/13/84

The following rates are prescribed for the customers in the area served by Auxier Water Company, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

RATES: Monthly

First	1,000 gallons	\$6.95 Minimum Bill
Next	1,000 gallons	3.85 per 1,000 gallons
Next	6,000 gallons	3.30 per 1,000 gallons
Next	6,000 gallons	2.70 per 1,000 gallons
Over	14,000 gallons	2.15 per 1,000 gallons